

Internal Revenue Service
NO POSTAGE RECEIVED

Leave Copies to District

Date

1/25/99 1/28/99

Signature

Department of the Treasury

Washington, DC 20224

Contact Person:

Telephone Number:

In Reference to:

OP:E:EO:T:1

Date:

SEP 21 1998

Employer Identification Number:

Key District:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

FACTS

You were incorporated on [REDACTED] as a nonprofit corporation [REDACTED]. According to your Articles of Incorporation, you are organized and operated primarily to facilitate the delivery of efficient and cost effective health care in [REDACTED]. Such activities include: 1) evaluating the health care needs of the community, 2) generating wellness programs, and 3) marketing preferred provider plans.

In Part II of Form 1023 you state that your activities shall also include "provid[ing] support to community hospitals and business leaders in their day to day dealings with various "Managed Care Companies." In accomplishing this goal, your services include, but are not limited to: 1) establishing a stronger basis to actively participate in managed care contracts; 2) enhancing communication between participants; 3) providing strategic leverage when dealing with payers during negotiations; 4) providing opportunities to promote a recognized regional Health Delivery System with a reputation for its commitment to quality health care; and 5) providing your members with the structure to align more effectively the interest of hospital, physicians and business leaders.

You are a wholly owned subsidiary of [REDACTED] [REDACTED] ([REDACTED]). [REDACTED] provides [REDACTED] ([REDACTED]) of your financial support. In return, you are financially accountable to [REDACTED].

[REDACTED]

Your membership is available to all not for-profit hospitals within [REDACTED] area and their respective medical staffs. However, such membership does not carry with it any right to direct or control any activity. From a legal perspective, your sole member is [REDACTED].

LAW

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, scientific or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 501(e) of the Code provides that a cooperative hospital service organization is treated as if it were exempt under section 501(c)(3) if it performs certain specific service activities enumerated in the statute for two or more exempt hospitals and allocates or pays, within 8-1/2 months after the end of the year, all net earnings to its members on the basis of the services performed for them.

Section 502 of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for-profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

Section 1.501(a)-1(c) defines a "private shareholder or individual" as any person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(b)(1) of the Income Tax Regulations provides that an organization is organized for one or more exempt purposes only if its Articles of Organization (a) limit the purposes of such organization to one or more exempt purposes and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the Regulations provides that an organization will not be considered as operated exclusively for charitable purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized nor operated exclusively for one or more charitable purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized nor operated for the benefit of private interest such as designated individuals.

Section 1.501(c)(3)-1(d)(2) of the Regulations provides that the term "charitable" is used in Code section 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second), Trusts, sec. 368 and sec. 372; IV Scott on Trusts (3d ed. 1967), sec. 368 and sec. 372; and Rev. Rul. 69-545, 1969-2 C.B. 117.

Section 1.501(c)(3)-1(e) of the Regulations states that an organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3) of the Code.

Section 1.501(a)-1 of the Regulations provides that section 501(e) is the exclusive and controlling section under which a cooperative hospital service organization can qualify as a charitable organization.

Section 1.502-1(b) of the Regulations provides that a subsidiary organization of a tax exempt organization may be exempt on the ground that the activities of the subsidiary are an integral part of the exempt activities of the parent organization. However, the subsidiary is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business if regularly carried on by the parent organization.

Rev. Rul. 54-305, 1954-2 C.B. 127, describes an organization whose primary purpose is the operation and maintenance of a purchasing agency for the benefit of its otherwise unrelated members who are exempt as charitable organizations. The ruling held that the organization did not qualify under section 101(6) of the Code (the predecessor to section 501(c)(3)) because its activities consisted primarily of the purchasing of supplies and performing other related services. The ruling stated that such

activities in themselves cannot be termed charitable but are ordinary business activities.

Rev. Rul. 69-528, 1969-2 C.B. 127, describes an organization formed to provide investment services on a fee basis only to organizations exempt under section 501(c)(3) of the Code. The organization invested funds received from participating tax-exempt organizations. The service organization was free from the control of the participating organizations and had absolute and uncontrolled discretion over investment policies. The ruling held that the service organization did not qualify under section 501(c)(3) of the Code and stated that providing investment services on a regular basis for a fee is a trade or business ordinarily carried on for-profit.

Rev. Rul. 69-545, 1969-2 C.B. 117, establishes that a nonprofit organization whose purpose and activity include providing hospital care is promoting health and may, therefore, qualify as organized and operated in furtherance of a charitable purpose, provided other requirements of section 501(c)(3) are satisfied.

Rev. Rul. 72-369, 1972-3 C.B. 245, describes an organization formed to provide management and consulting services at cost to unrelated exempt organizations. This Revenue Ruling states:

Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for-profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code.

Rev. Rul. 70-535, 1970-2 C.B. 117, describes an organization formed to provide management, development and consulting services for low and moderate income housing projects for a fee. The Revenue Ruling held that the organization did not qualify under section 501(c)(4) of the Code. The Revenue Ruling stated:

Since the organization's primary activity is carrying on a business by managing low and moderate income housing projects in a manner similar to organizations operated for-profit, the organization is not operated primarily for the promotion of social welfare. The fact that these services

are being performed for tax exempt corporations does not change the business nature of the activity.

Rev. Rul. 75-197, 1975-1 C.B. 156, held that a nonprofit organization that operates a free computerized donor authorization retrieval system to facilitate transportation of body organs upon a donor's death qualifies for exemption under section 501(c)(3) of the Code because by facilitating the donation of organs which will be used to save lives, it is servicing the health needs of the community and therefore is promoting health within the meaning of the general law of charity.

Rev. Rul. 77-68, 1977-1 C.B. 142, held that a nonprofit organization formed to provide individual psychological and educational evaluations, as well as tutoring and therapy, for children and adolescents with learning disabilities qualified for exemption under section 501(c)(3) of the Code because it promoted health and advanced education. Because its services are designed to relieve psychological tensions and thereby improve the mental health of the children and adolescents, it promoted health.

In Rev. Rul. 81-276, 1981-1 C.B. 128, the Service held that a PSRO qualifies for exemption under section 501(c)(3) of the Code because it lessens the burdens of government and promotes the health of the beneficiaries of the Medicare and Medicaid programs.

Rev. Rul. 81-298, 1981-1 C.B. 328, held that a nonprofit organization that provides housing, transportation and counseling to hospital patients' relatives and friends who travel to the locality to assist and comfort the patients qualifies for exemption under section 501(c)(3) of the Code because it promotes health by helping to relieve the distress of hospital patients who benefit from the visitation and comfort provided by their relatives and families.

Rev. Rul. 86-98, 1986-2 C.B. 74, involved an individual practice association (IPA) of private practice physicians whose purpose was to arrange for the delivery of health services through contracts negotiated with health maintenance organizations (HMOs). The IPA's primary activities were to serve as a bargaining agent for its members in dealing with HMOs and to performed the administrative claims services required by the agreements negotiated with the HMOs. The Service found that the IPA did not provide HMO patients with access to medical care which would not have been available but for the establishment of the IPA, nor did it provide such care below reasonable and

customary fees. Because the IPA operated in a manner similar to organizations carried on for-profit and its primary beneficiaries were its member-physicians rather than the community as a whole, the Service denied the IPA exemption under sections 501(c)(4) and 501(c)(6) of the Code.

In Better Business Bureau of Washington, DC v. United States, 326 U.S. 279, 283 (1945), the Court held that "the presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

In B.S.W. Group, Inc. v. Comm., 70 T.C. 352 (1978), the organization entered into consultant-retainer relationships with five or six limited resource groups involved in the fields of health, housing, vocational skills and cooperative management. The organization's financing did not resemble that of the typical section 501(c)(3) organization. It had neither solicited, nor received, any voluntary contributions from the public. The court concluded that because its sole activity consisted of offering consulting services for a fee, set at or close to cost, to nonprofit, limited resource organizations, it did not qualify for exemption under section 501(c)(3) of the Code.

In Christian Stewardship Assistance, Inc. v. Comm., 70 T.C. 1037 (1978), a nonprofit corporation that assisted charitable organizations in their fund raising activities by providing financial planning advice on charitable giving and tax planning to wealthy individuals was held not to qualify under section 501(c)(3) of the Code because its tax planning services were a substantial nonexempt activity enabling the corporation to provide commercially available services to wealthy individuals free of charge.

An organization that merely promotes health, without more, is not entitled to recognition of exemption under section 501(c)(3) of the Code. For example, while selling prescription pharmaceutical promotes health, pharmacies cannot qualify for recognition of exemption under section 501(c)(3) on that basis alone. In Federation Pharmacy Service, Inc. v. Comm., 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980), the Tax Court stated, at 72 T.C. 692:

Virtually everything we buy has an effect, directly or indirectly, on our health. We do not believe that the law requires that any organization whose purpose is to benefit health, however remote, is automatically

entitled, without more, to the desired exemption.

In HCSC-Laundry v. U.S., 450 U.S. 1 (1981), the Supreme Court held that a cooperative laundry organization that served exempt organizations could not qualify as exempt under section 501(c)(3) because laundry services is not one of the activities enumerated in section 501(e).

Living Faith, Inc. v. Comm., 920 F.2d 365 (7th Cir. 1991), involved an organization that operated restaurants and health food stores with the intention of furthering the religious work of the Seventh-Day Adventist Church as a health ministry. However, the Seventh Circuit held that these activities were primarily carried on for the purpose of conducting a commercial business enterprise. Therefore, the organization did not qualify for recognition of exemption under section 501(c)(3) of the Code.

In Professional Standard Review Organization of Queens County, Inc. v. Comm., 74 T.C. 240 (1980), acq., 1980-2 C.B. 2 (Queens County PSRO), the Tax Court held that an organization that reviewed the propriety of hospital treatment provided to Medicare and Medicaid recipients was exempt under section 501(c)(3) of the Code because it lessened the burdens of government and promoted the health of persons eligible for Medicare and Medicaid.

RATIONALE

1. To qualify for exemption under section 501(c)(3) of the Code, an organization must be organized exclusively for an exempt purpose. Though the promotion of health is considered a charitable purpose within the meaning of section 501(c)(3) of the Code, Rev. Rul. 69-545, supra, the Service and Courts have recognized that the promotion of health includes activities other than the direct provision of patient care. See Rev. Rul. 81-298, supra, Rev. Rul. 81-276, supra, Rev. Rul. 77-68, supra, Rev. Rul. 75-197, supra; and Queens County PSRO, supra.

However, an organization that merely promotes health without more, is not entitled to recognition of exemption under section 501(c)(3) of the Codes. See Living Faith, Inc., supra and Federation Pharmacy Services, Inc., supra. Although your activities promote health, you do not promote health in a charitable manner. Any benefits derived by the community from your activities are remote and incidental.

Providing marketing, management and consulting services for a group of tax-exempt health care providers does not directly

promote health. Instead, you are providing ordinary commercial services. Providing ordinary business services for one or more exempt health care organizations does not promote health in a charitable manner. See Rev. Rul. 70-535, supra, Rev. Rul. 54-305, supra; Rev. Rul. 69-528, supra; Rev. Rul. 72-369, supra; and B.S.W. Group, Inc., supra, and Christian Stewardship Assistance, Inc., supra. Therefore, you are neither organized nor operated exclusively for charitable purposes under section 1.501(c)(3)-1(b) nor 1.501(c)(3)-1(c)(1) of the Regulations.

2. Under section 1.502-1(b) of the Regulations, one organization may derive its exemption from a related organization exempt under section 501(c)(3) of the Code if it is an integral part of the exempt organization. To obtain exemption derivatively, two requirements must be satisfied: (1) the two organizations must be "related" and (2) the subordinate entity must perform "essential" services for the parent. The related organization must be structurally related, not just functionally related, to be considered related for purposes of the integral part theory. Section 1.502-1(b)(1) of the Regulations includes the following example of an organization that is providing essential services: a subsidiary which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax exempt educational organization, in carrying on its educational activities.

The Regulations also describe circumstances in which a subsidiary would not qualify for section 502; i.e., a subsidiary organization that is engaged in activity that would be considered an unrelated trade or business if it were regularly carried on by the exempt parent does not provide an essential service to the parent. The Regulations include an example of a subsidiary organization that is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization.

Similarly, if the subsidiary organization were owned by several unrelated exempt organizations and operated for the purpose of furnishing electric power to each of them, it would not be exempt because the business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For this purpose, organizations are related only if they consist of (1) a parent and one or more of its subsidiaries, or subsidiaries having a common parent. An exempt organization is not related to another exempt organization merely because they both engage in the same type of exempt activities. See section 1.501(2)-1(b) of the Regulations.

Though you are a subsidiary of an exempt organization, you

are organized and operated for the purpose of providing various marketing, consulting and network management services to several unrelated tax-exempt members. You are not "structurally" related to your members. Hence, you do not satisfy the "related requirement" of the integral part theory test and you cannot receive exemption derivatively under section 502 of the Code. Section 1.502-1(b).

3. An organization that provides services for more than one exempt hospital, including outpatient clinics, may qualify for exemption under section 501(c)(3) if it meet the requirements of section 501(e) of the Code. However, the exemption applies only to organizations providing the services specifically enumerated in the statute and the Regulations. Since section 501(e) is the exclusive means by which a hospital service organization may qualify for exemption under section 501(c)(3) (See section 1.501(e)-1 of the Regulations and HCSC-Laundry, supra), a hospital service organization providing services other than those specifically enumerated in the statute does not qualify.

The various marketing, consulting and network management services you provide to your tax-exempt hospital members are not services specifically enumerated in section 501(e) of the Code. Therefore, under section 501(e), you do not qualify as an organization that is treated as exempt under section 501(c)(3).

4. Under sections 1.501(c)(3)-1(c)(2) and 1(d)(1)(ii) of the Regulations, an organization cannot qualify for exemption if: 1) its earnings inure to, in whole or part, to the benefit of a private individual and 2) a private interest is served instead of a public interest. In your Form 1023, you indicate that your membership is open to each unrelated exempt hospital's medical staff.

Because your services include marketing and negotiating on the behalf of individuals of the medical staff, you are advancing the private and personal interest of such individuals. There is no broad community benefit derived from such activities; hence, you do not qualify as an organization that is treated as exempt under section 501(c)(3).

CONCLUSION

For the reasons stated above, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

[REDACTED]

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

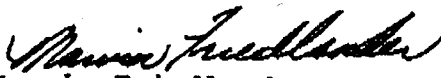
When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
Attn: CP:E:EO:T:1; Room 6142
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you wish to FAX any information to us, our FAX number is [REDACTED]. If you have any questions, please contact the

person whose name and telephone number are shown in the heading of this letter.

Sincerely,


Marvin Friedlander
Chief, Exempt Organizations
Technical Branch 1